B 530-2

10/81

The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

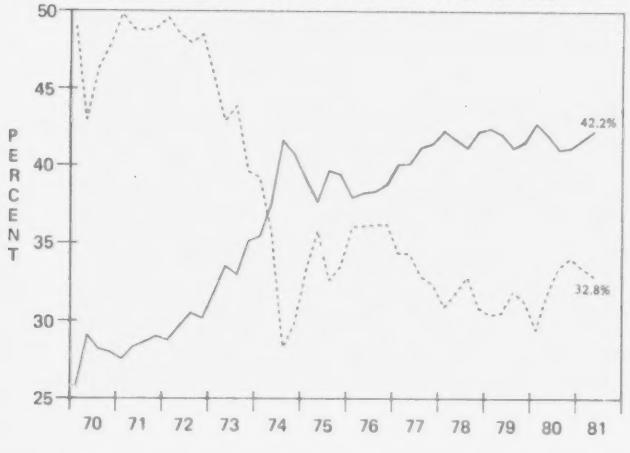
MONDAY, OCTOBER 5, 1981 VOLUME XVIII, NUMBER 40

The Evidence Mounts . . .

The specter of renewed recession once again looms on the horizon. The index of leading economic indicators dropped again in August, the slump in residential construction and new-home sales has worsened, industrial production has turned down and new factory orders have eased. But in the final analysis, trends in consumer spending will be the main determinant of whether or not the economy does, indeed, slip into another recession. In turn, the major determinant of the level of consumer spending is the condition of household balance sheets.

A low rate of financial asset acquisition (stocks and bonds, for example) and/or an erosion of net worth due to inflation may well presage some curtailment of consumer spending. At the same time, a sharp upturn in the level of auto and mortgage debt outstanding at prevailing lofty interest rates would ensure that repayment of these obligations will absorb an increasingly larger proportion of disposable income. Already the strength of household finances has been eroded by high rates of inflation

DEPOSIT-TYPE ACCOUNTS AS A PERCENT OF TOTAL HOUSEHOLD FINANCIAL ASSETS (LINE) VS. EQUITY HOLDINGS AS A PERCENT OF TOTAL HOUSEHOLD FINANCIAL ASSETS (DOT)



and finance charges which, if accompanied by an upturn in the unemployment rate and slower personal incomes growth later this year, could foreshadow a sizable cutback in consumer spending.

Such dire predictions would seem exaggerated if one were to look at trends in consumer installment debt alone. With automobile sales sluggish and consumers turning increasingly cautious in response to widespread predictions of imminent recession, households have trimmed their level of installment credit purchases so far this year. Installment debt outstanding increased by less than $1.9 billion per month during the first seven months of 1981—almost 20 per cent below the average monthly increase in installment debt outstanding during the comparable period of the preceding five years. This cautious use of debt, together with buoyant disposable income gains, lowered the key installment debt-to-disposable income ratio to just a shade under 16 per cent in the second quarter of 1981, well below the almost 18 per cent peak reached in the fall of 1979.

At the same time, disposable income growth far outstripped debt repayments, lowering the repayments-to-disposable income ratio from a high of 18.2 per cent in the spring of 1979 to 15.9 per cent currently—its lowest level since late 1976. What is more, household cash flow has received a significant boost from high interest rates. The monthly level of installment debt repayments ($26.8 billion in July) now stands only slightly above the monthly level of household interest income ($25.8 billion in July), the first time ever that interest income has almost completely offset debt repayments.

. . . That Consumer Spending . . .

But trends in installment debt alone do not offer a complete picture of household indebtedness. To this must be added mortgage debt which, at least through the first half of 1981, continued to post sizable gains—albeit at ever higher interest rates. Boosted by still rising home prices and second mortgage borrowings, mortgage debt outstanding rose by $40 billion during the first six months of 1981, not far from the average increase posted during the comparable period of the preceding five years—even though new-home sales fell. Moreover, this debt was contracted at increasingly higher interest rates. They have recently ranged as high as 18-19 per cent, well above the nine to ten per cent average

Copyright 1981
Manufacturers Hanover Trust Company
350 Park Avenue, New York, NY 10022

which prevailed during most of the 1976-80 period.

Thus, another indicator of household liquidity, the estimated household debt service burden—consisting of interest payments only on outstanding installment and mortgage debt—moved noticeably higher. It now stands at 8.6 per cent of disposable income, a record high level and well above the approximately 5.5 per cent ratio which prevailed prior to the 1973-75 recession. If repayments of mortgage principal were added to the interest repayments, this level would move higher still.

Nor has household financial asset acquisition been stepped up to keep pace with the rising debt service burden. In fact, just the opposite has occurred. Most recently, the escalation of interest rates has sent bond and equity prices plunging, sharply eroding the value of household financial assets. And since changes in the market value of these assets have also influenced spending decisions, it appears likely that more weakness in consumer spending is in the offing. Specifically, the pace of household financial asset acquisition expressed as a percentage of disposable income dropped sharply in the first half of 1981, skidding to less than 14 per cent, its lowest level since 1974. What is more, this ratio undoubtedly slumped even further in the third quarter as a result

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/23/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	132.916	+ 1.003	+ 4.035
Loans to Depository Inst.	1.446	+ .097	− .184
Float	3.339	− .482	− 1.023
Total Reserve Bank Credit	146.212	+ .777	+ 6.024
Treasury Deposits with Federal Reserve Banks	3.352	+ .355	+ .226
Currency Outside Banks	124.118	+ .038	+ 6.328
Member Bank Reserves:			
Required	40.391	+ .568	− 1.173
Excess (Deficiency)	.132	− .121	+ .053
Total Reserves Held	40.523	+ .447	− 1.120
Net Borrowed Reserves	1.084	+ .193	− .436
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	91.674	− 1.176	+ 7.686

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	431.7	+ 3.5‡	+ 5.2‡
M2 (August '81)	1,779.0	+ 8.2	+ 8.9
M3 (August '81)	2,119.5	+ 11.4	+ 11.7
L (June '81)	2,502.7	+ 9.4	+ 11.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 10/2/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.35%	14.50%	14.20%
* Federal Agencies	14.60	15.56	15.85
* Project Notes—Taxfree (46% Taxable Equivalent)	15.93	16.67	16.85
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	16.85	17.00	17.65

‡Finance Company Paper—Prime

5- 14 days	16.13%
15- 29 days	16.62
30- 59 days	15.50
60- 89 days	15.50
90-179 days	14.75
180-239 days	14.50
240-270 days	14.50

‡* Bankers' Acceptances

Nov.	15.40%
Dec.	15.60
Jan.	15.80
Feb.	15.80
Mar.	15.70
Apr.	15.60

‡Industrial Paper—Prime

30- 89 days	15.00%
90-120 days	15.50

†Federal Funds Effective Rate 16.90%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81	$ 2,886	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81	$ 1,510	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81	− 1.6%	8.6%	− 9.9%
Change in Consumer Prices (all urban consumers)*	Aug '81	9.6%	14.4%	9.6%
Change in Producer Prices*	Aug '81	3.6%	4.8%	14.4%
Civilian Employment (Thousands of Persons)†	Sep '81n	98,270	98,944	97,180
Unemployment as % of Civilian Labor Force†	Sep '81n	7.5%	7.2%	7.4%
Personal Income*	Aug '81	$ 2,446	$ 2,419	$ 2,179
Leading Indicators Composite Index (1967=100)†	Aug '81n	133.8	134.5	130.7
Industrial Production Index (1967=100) †	Aug '81	152.8	153.4	142.2
Net Change in Consumer Installment Credit†	Jul '81	$ 1.95	$ 1.93	−$ 1.20
U.S. Merchandise Trade Balance †	Aug '81n	−$ 4.48	−$ 0.54	−$ 0.63
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Aug '81	937	1,049	1,411
New Construction Expenditures*	Aug '81n	$ 231.0	$ 234.8	$ 217.9
Total Business Inventories†	Jul '81	$ 499.5	$ 494.2	$ 466.8
Total Business Sales†	Jul '81	$ 354.6	$ 354.4	$ 315.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

of the approximately $250 billion slide in the value of household equity investments since June.

The total drop in the value of household equity holdings since the beginning of the year now amounts to about $260 billion. While this decline is still well below the enormous $409 billion slide which occurred in 1973 and 1974, prior to and during much of the 1973-75 recession, it is more than twice the $115 billion decline in household equity holdings which occurred prior to the 1970 recession. Although, when expressed as a percentage of disposable income, the most recent slide in equity holdings is still less than the 1970 decline, the adverse impact on investor psychology arises from actual dollar, not percentage, drops.

. . . Will Weaken Further

Despite the slump in bond and stock prices, however, consumer spending has not yet been deterred all that much, at least not yet. Although "real" personal consumption spending contracted at a seasonally adjusted two per cent annual rate in the second quarter of 1981 compared with quarter-earlier levels, most of the drop was due to slumping automobile sales. Excluding autos, real consumer spending rose at an almost two per cent seasonally adjusted annual rate. Two factors may account for

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (9/16/81)	128,250	− 840	+33,135
New York City (9/16/81)	30,923	+ 156	+ 8,640
Commercial Paper (9/16/81)	160,254	+ 4,264	+38,128

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/16/81)	185,286	+ 1,200	+21,747
New York City (9/16/81)	54,183	+ 481	+ 5,889

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/16/81)	453,043	+ 1,551	+47,978
New York City (9/16/81)	108,362	+ 102	+15,994

Financial Markets

	Friday 10/2/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	15.00%	+ .28	+ 3.23
180-Day Bills†	15.85	+ .15	+ 3.88
Longest Bills†	16.03	− .08	+ 4.05
Recent Issues:			
16s 9/30/83	16.35	+ .46	
15⅞s 9/30/85	15.30	− .60	
14⅞s 8/15/91	14.47	− .73	
13⅞s 5/15/11	13.60	− 1.55	
Municipals:			
Bond Buyer−20 Bond Index* (10/1/81)	12.93%	+ .36	+ 3.71
Blue List Total ($ Million)	$ 736	+ $128	+ $ 48
30-Day Visible Supply ($ Million)	$1,831	+ $399	− $ 217
Total	$2,567	+ $527	$ 169
Corporates:			
Moody's Aa Composite (10/1/81)	16.46%	+ .51	+ 3.50
30-Day Visible Supply ($ Million)	$7,724	− $105	+ $3,824
Stocks:			
Dow-Jones Averages:			
Industrials	860.73	+ 36.72	− 89.95
Transportation	365.44	+ 29.96	+ 20.02
Utilities	102.81	+ .60	− 8.40
65 Stocks	337.22	+ 16.63	− 15.25
Standard and Poor's 500 Stocks	119.36	+ 6.59	− 9.97
N.Y.S.E. Composite Index	68.86	+ 3.90	− 5.89
N.Y.S.E. Avg. Daily Vol. for Week (000's)	49,676	+ 64	+ 3,818

* 46% Taxable equivalent 23.94%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/2/81	Week Ago
Overnight	16.25%	15.25%
1 month	16.75	16.25
3 month	17.63	17.38
6 month	17.94	17.63
1 year	17.38	17.13
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.80%	15.70%
Long Term (7 to 15 yrs.)	15.70	15.55

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/2/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02661	37.58
Canada	.8308	1.2036
Denmark	.1367	7.3145
France	.1817	5.5050
Germany	.4361	2.2933
Italy	.0008525	1173.00
Japan	.004337	230.60
Mexico	.03960	25.25
Netherlands	.3922	2.5500
Switzerland	.5164	1.9365
U.K.	1.8303	.5464

this seeming contradiction.

In the case of bonds, the spending decisions of many long-term investors are likely to be little affected by fluctuations in the market value of their bond holdings, as long as the flow of interest income from these securities is uninterrupted. Barring borrower default, these payments continue, irrespective of fluctuations in the market value of the fixed-income portfolio. The downturn in equities prices, in contrast, should have a more immediate impact since stocks are more widely held by the public. But even here the effect may be less severe than in the past. Household equity investments as a percentage of total household financial assets has diminished over time—from almost 50 per cent in early 1970 to approximately 33 per cent during the past year. The growth of deposit-type assets has taken up much of the slack, rising from about 28 per cent of household assets in 1970 to 42 per cent currently. (See chart on first page.)

Although diminished, the value of equities held remains an important component of household net worth. With stock prices in a seeming free-fall, it can not help but be translated into reduced household perceptions of their ability to spend. What is more, the recent flattening in home prices ensures that rising home values will not offset the adverse effects of the downturn in share prices. H

Manufacturers Hanover Geobankers in Guangzhou
(Canton)

Customers and friends are welcome to consult Mantrust officers in Suite 2348, Dong Fang Hotel (Old Wing), during the 50th Chinese Export Commodities Fair, October 15 through November 15, 1981.

Pioneering Geobankers will serve you again in Canton. For discreet, professional and experienced advice on financing your piece of the China trade action, from straight trade and processing contracts through compensation trade arrangements, cooperative manufacturing and joint venture arrangements, the Geobankers are there to benefit you.

In Hong Kong:
Alexandra House, 27th floor
Hong Kong
Tel: (5) 253101
Telex: 73951 HX

James W. Sweitzer
Vice President
and Manager

Edward Lau
Assistant Vice President

Johnson C. Fu
Assistant Vice President

Paul Au
Assistant Secretary

In New York:
350 Park Avenue
New York, New York 10022
Tel: (212) 350-3201/350-6924
Telex: 232337

John J. Simone
Senior Vice President

Iain A. Duthie
Assistant Vice President

Richard V. Johnson
Vice President

Paul Balaran
Assistant Secretary

MANUFACTURERS HANOVER
The banking source. Worldwide.